

**MINUTES OF THE REGULAR MEETING OF THE
ARIZONA STATE RETIREMENT SYSTEM BOARD**

**HELD ON
Friday, October 20, 2000
8:30 a.m., MST**

The Arizona State Retirement System (ASRS) Board met in the 10th Floor Board Room of the ASRS office at 3300 North Central Avenue, Phoenix, Arizona 85067-3910. Mr. Jim Bruner, Vice-Chairman, ASRS Board, called the meeting to order at 8:30 a.m., MST.

The meeting was teleconferenced to the ASRS Tucson office, 7660 East Broadway Boulevard, Suite 108, Tucson, Arizona 85710-3776.

1. Call to Order; Roll Call; Opening Remarks

Present: Mr. Jim Bruner, Vice Chairman
Dr. Merlin DuVal
Ms. Bonnie Gonzalez
Mr. Jim Jenkins
Mr. Alan Maguire (via teleconference)
Mr. Norman Miller
Mr. Ray Rottas

Excused: Dr. Chuck Essigs, Chairman
Mr. Karl Polen

A quorum was present for the purpose of conducting business.

2. Approval of Minutes of the September 15, 2000 Regular Meeting of the ASRS Board

Motion: Dr. Merlin DuVal moved to approve the minutes of the September 15, 2000 regular meeting of the ASRS Board.

Ms. Bonnie Gonzalez seconded the motion.

By a vote of 7 in favor, 0 opposed, 0 abstentions, 2 excused, the motion was approved.

3. Board Approval of Consent Schedule

Motion: Mr. Jim Jenkins moved that the ASRS Board approve the summary report of Retirements, Refunds and Death Benefits; System Transfers; and Applications and Agreements between the ASRS and the following Employers:

- (1) Evergreen Charter School Corp.
- (2) Sedona-Oakcreek Airport Authority, Inc.
- (3) Desert Springs Academy Charter School

Dr. Merlin DuVal seconded the motion.

By a vote of 7 in favor, 0 opposed, 0 abstentions, 2 excused, the motion was approved.

4. Presentation, Discussion and Appropriate Action Regarding the Performance of Domestic Fixed Income Managers for the Period Ending June 30, 2000

Mr. Terry Dennison, Principal, Mercer Investment Consulting, Inc., reported on the performance of the Domestic Fixed Income Managers from the Arizona State Retirement System (F1), Barclays Global Investors (BGI), BlackRock, JP Morgan Investment Management, Inc., and Western Asset Management Company (WAMCO), for the period ending June 30, 2000.

Mr. Gary Dokes, Portfolio Manager, Mr. Matt Henderson, Assistant Portfolio Manager and Ms. Lupita Breland, Assistant Portfolio Manager reported on the ASRS' (F1) performance for the period ending June 30, 2000.

	Quarter Ending 6/30/00	Inception*
Sector Weighting	+0.01	+0.01
Security Selection	-0.01	-0.01
Other	-0.00	-0.00
Fees	-0.00	-0.01
Total Value Added	-0.00	-0.01

* As of 3/31/98

Mr. Vache Mahseredjian, Investment Strategist, and Mr. David Lissek, Associate, reported on BGI's performance for the period ending June 30, 2000.

As of 06/30/00	2Q00	1 Year	I-t-D
Intermediate Government Fund Outperformance	0.014%	0.078%	0.078%
Intermediate Government Fund Fees	-0.004%	-0.018%	-0.018%
<i>Total Value Added vs. Benchmark</i>	<i>0.010%</i>	<i>0.060%</i>	<i>0.060%</i>
Intermediate Credit Fund Outperformance	0.014%	0.018%	0.028%
Intermediate Credit Fund Fees	-0.004%	-0.018%	-0.018%
<i>Total Value Added vs. Benchmark</i>	<i>0.010%</i>	<i>0.000%</i>	<i>0.010%</i>
Long Credit Fund Outperformance	-0.026%	0.008%	-0.163%
Long Credit Fund Fees	-0.004%	-0.018%	-0.017%
<i>Total Value Added vs. Benchmark</i>	<i>-0.030%</i>	<i>-0.010%</i>	<i>-0.180%</i>

(Continued) As of 06/30/00	2Q00	1 Year	I-t-D
Long Government Fund Outperformance	0.014%	N/A	-0.013%
Long Government Fund Fees	-0.004%	N/A	-0.017%
<i>Total Value Added vs. Benchmark</i>	<i>0.010%</i>	<i>N/A</i>	<i>-0.030%</i>
Mortgage-Backed Fund Outperformance	0.044%	0.118%	0.108%
Mortgage-Backed Fund Fees	-0.004%	-0.018%	-0.018%
<i>Total Value Added vs. Benchmark</i>	<i>0.040%</i>	<i>0.100%</i>	<i>0.090%</i>

Ms. Sandra Familet, Vice-President, and Mr. Rajiv Sobti, Managing Director, reported on BlackRock's performance for the period ending June 30, 2000.

Total Rate of Return	2nd Quarter 2000	Since Inception* Annualized
Duration/Yield Curve Management	+02	+10
Security Selection/Sector Allocation	+19	+21
Fees	-.04	-.16
Excess Return	+17	+15

* As of 12/1/98

Mr. Luke E. Farrell, Vice-President, reported on JP Morgan Investment Management, Inc.'s performance for the period ending June 30, 2000.

Attribution	Quarter	1 Year	3 Years
Duration Management	+0.03	+0.40	+0.31
Sector Emphasis	0.00	+0.10	-0.12
Security Selection	-0.13	+0.14	+0.10
Fees	-0.03	-0.14	-0.18
Total Value Added Relative to Benchmark	-0.13	+0.50	+0.11

Mr. Joseph Carieri, Client Service Executive, reported on WAMCO's performance for the period ending June 30, 2000.

Relative Performance (bps)	2nd QTR	1 Year	Since Inception*
Duration	0.1	-0.2	-0.5
Yield Curve	0.1	0.1	0.1
Sector Selection	0.1	0.2	0.2
Issue Selection	-	0.2	0.3
Fees	-0.1	-0.2	-0.2
Value Added	0.2	0.1	-0.1

*12/3/98 – 6/30/00

Mr. Ray Rottas asked Mr. Dennison to comment on some of the problems that are emerging from mergers and buyouts and the effect they may have on the economy and the ASRS.

Mr. Dennison replied that the rationale behind a merger is that the sum of the parts is worth

more than the individual pieces. But as the economy slows down, it is less likely that the benefits that were projected are going to eventuate. Some of the recent market volatility is caused by a greater number of companies failing to meet expectations. He anticipates a negative total fund return this year because of the uncertainty in the market, but the ASRS is a long-term investor, well diversified in strategy and style, and he believes the fund and the members' benefits are secure.

5. Presentation, Discussion and Appropriate Action Regarding the Appointment or Removal of ASRS Investment Managers and the Management of Assets

Mr. Paul Matson provided a brief background on the MidCap managers that handle ASRS funds, specifically Consec Capital Management. Consec has performed well, but over the past year has had some problems, resulting in lower stock value and employee turnover. The ASRS staff has been monitoring the situation and updating the Board. Because of a number of issues, such as potential liquidity problems, asset write-offs and staff departures, including the CIO of equity and three portfolio managers, the ASRS staff now believe Consec should be terminated.

Mr. Matson also discussed the pros and cons of three alternatives for handling the assets should the Board choose to terminate Consec: 1) State Street Global Advisors – passive 2) Mellon Equity – active 3) ASRS E3 Portfolio – passive.

Mr. LeRoy Gilbertson, ASRS Director, focused on the exit of a number of staff, because those individuals produced the performance of the ASRS funds over the past 18 months. He believes the company will be in turmoil as it hires new staff and will be focused on transition rather than the portfolio.

Mr. Jim Jenkins inquired about the maximum percentage of assets the Board has agreed can be internally managed. Mr. Matson responded that he believes there is no Board resolution that sets a maximum allocation, but the Board did not want more than 33% of assets to be managed internally upon the completion of the equity/fixed allocation transition.

Ms. Bonnie Gonzalez clarified that much of the concern about Consec is about the individuals who will or will not be assigned to handle the ASRS funds. Mr. Matson responded that he has talked with Consec about its transition plan. It is seeking new staff members and is not going to do any significant trading, but did not appear to have a clearly identifiable plan of action for the human resource search. He also reminded the Board that every year there is a request-for-proposal (RFP) on this asset class, so the assets currently managed by Consec will only be moved to a new manager temporarily. He will encourage all of the asset managers, including Consec, to respond to the new RFP and bid for the assets.

Motion: Mr. Ray Rottas moved that Consec Capital Management be terminated in the quickest possible time.

Mr. Jenkins seconded the motion.

Mr. Norman Miller asked why Consecos was not present to discuss its plan to remedy the situation. He also asked for Mr. Terry Dennison's observations and recommendations.

Mr. Matson responded that the ASRS staff has been monitoring the situation closely and has spent significant resources obtaining information to accurately reflect what Consecos is doing. Informing a manager it may be terminated may create more staff departures or some transactions that might not normally occur, so the ASRS staff determined not to invite them.

Mr. Dennison observed that he has been concerned about the stability of the Consecos staff and with the level of disorder in the company, as they may be more concerned with running themselves than with the assets. An independent evaluation of Consecos found that the organization that maintained the structure, philosophy, and process is no longer there. At this stage, he strongly supports the ASRS staff's recommendation to terminate.

Mr. Jenkins asked when the RFP process would begin and whether it could be accelerated.

Mr. Alan Maguire said that as the ASRS has gone through the RFP process over the past couple of years, it has focused on the personnel directly involved in handling the funds and the style of the manager and whether it was appropriate for the overall portfolio strategy. With major departures, particularly those of individuals involved in the ASRS portfolio, Consecos has changed who they are. He also suggested putting the MidCap RFP process in line with the Small Cap process to accelerate the selection of new managers by six months.

By a vote of 7 in favor, 0 opposed, 0 abstentions, 2 excused, the motion was approved.

Mr. Matson noted the International managers have all outperformed the benchmark this year, so the ASRS could replace the International RFP with the MidCap RFP. There could be Small Cap and MidCap RFPs this year and an International RFP next year.

Motion: Dr. Merlin DuVal moved to speed up the process for the RFP bids for the MidCap and move back one year the process as it relates to International managers.

Mr. Miller seconded the motion.

By a vote of 7 in favor, 0 opposed, 0 abstentions, 2 excused, the motion was approved.

Mr. Jenkins asked for Mr. Dennison's recommendation on the alternatives for the temporary management of the assets. Mr. Dennison responded that all three options consider the allocation between active and passive and the allocation between internal and external, but the Board should also look at the allocation between growth versus value. He believes the assets should have exposure to the MidCap Growth category and asked if the internal E3 option would run an index for the S&P 400 Growth. Mr. Matson responded that although that was not part of the original E3 proposal, it was not a significant change and could be done.

Mr. Maguire stated that he believes the closest possible practical allocation alternative would be an internal S&P 400 Growth Index.

Mr. Dennison recommended, given the assurance it is possible to run E3 along the lines mentioned, the assets should go to the internally managed E3 benchmarked to the S&P 400 Growth Index.

Mr. Rottas asked if it was a cost savings to manage the assets internally. Mr. Matson responded that the average cost of the running the E3 would be one basis point.

Mr. Jim Bruner asked about the timeframe for the transition. Mr. Matson responded that the E3 portfolio could be managed after Friday, October 20.

Motion: Mr. Jenkins moved to approve that the assets managed by Consecro Capital Management be transferred in-house for temporary management under a growth style MidCap equity strategy until further direction from the ASRS Board

Mr. Rottas seconded the motion.

Mr. Miller asked that the assets not only be managed under that philosophy but that they be benchmarked to it as well.

Modified Motion: Mr. Jenkins moved to modify the motion so that the assets be benchmarked to the S&P 400 Growth Index.

Mr. Maguire asked for clarification that the assets will be managed with a passive or enhanced passive strategy to the S&P 400 Growth Index fund.

Mr. Jenkins affirmed that was the intention of his motion.

Mr. Miller suggested “enhanced passive” be added to the motion for clarification.

Mr. Bruner suggested Mr. Matson restate the Board’s request so the ASRS investment staff understands what is expected.

Mr. Matson responded that the ASRS is to run the assets formerly managed by Consecro according to an enhanced passive/passive investment strategy with a benchmark of the S&P 400 MidCap Growth Index.

Substitute Motion: Mr. Ray Rottas moved that the ASRS run the assets formerly managed by Consecro Capital Management according to an enhanced passive/passive investment strategy with a benchmark of the S&P 400 MidCap Growth Index.

Mr. Miller seconded the motion.

By a vote of 7 in favor, 0 opposed, 0 abstentions, 2 excused, the motion was approved.

6. Director's Report

Mr. Norman Miller asked why, in the investment section of the Director's Report, the benchmark and the estimated returns of BGI and the F2 model were not included.

Mr. Paul Matson responded that the F2 was just converted so there is not a performance history yet. BGI can't be compared to the same benchmark because only their modules are indexed. The aggregation of those modules are not indexed. As of close of business last month, the modules are indexed in aggregation and they will be included in future reports.

Mr. Jim Bruner asked about any updates on the health insurance contracts.

Mr. Bill Cohee, Administrator for Member Services, reported that the State Procurement Office (SPO) determined that it was in the membership's best interest not to pursue a contract with BlueCross/BlueShield. It awarded all business to PacifiCare, which has the ability to provide all of the plan choices the ASRS has had over the past five years with different insurance carriers.

Dr. Merlin DuVal noted that BlueCross/BlueShield wanted exclusivity in some areas, which would have precluded other bidders in the process. In addition, its low bid for indemnity premiums was \$2529/month for a benefit package very comparable to PacifiCare's, which offered an indemnity premium of \$1354/month.

Mr. Cohee added that BlueCross/BlueShield also had suggested that if it were not successful in securing the same or greater number of members, it would reserve the right to come back and renegotiate the premiums over and above what was agreed. The state would not accept that.

Dr. DuVal suggested that the Legislature consider pooling the purchase of health insurance for all public employees and their employers, as well as the members of the retirement system. The state could then go into the market for bids with one large group. Mr. LeRoy Gilbertson responded that the legislature will have requests to look at different options and look to do something different.

Mr. Ray Rottas asked how many providers have a statewide position. Mr. Cohee responded that PacifiCare is the only carrier currently offering the various plans to satisfy the ASRS membership at the present time, although all the programs are not offered in all the counties.

Ms. Bonnie Gonzalez asked about the financial position of PacifiCare and whether it has been verified that there are hospitals and carriers who will accept it in all of the counties. Mr. Cohee stated that the greatest challenge for HMOs is pricing agreements with providers. In Colorado, PacifiCare took a risk when it contracted with providers and lost a significant amount of money. That loss has had no ill effects in Arizona because it does not have the same contracts here. It has made a substantial profit in the last several years in this state and it is the most successful carrier in insuring individuals who are currently under Medicare plans. Its PPO is found statewide and it has a substantial network satisfactory to take care of the ASRS membership.

7. Board Requests for Agenda Items

Mr. Miller commented that the External Relations and Legislative Board Committee is preparing a legislative agenda.

8. Call to the Public

Mr. Conrad Powell, of Phoenix and a founding member of the Maricopa County Community Colleges Retirees' Association, expressed concern about the cost of health insurance.

Ms. Charmé Moreheart and Pete Kellen, retired teachers from Camelback High School, asked for clarification and information about benefits they would receive from an early buyout package offered to them. Mr. Bruner thanked them for bringing the question to the Board's attention and directed them to the ASRS staff for more guidance.

Mr. Jim Seamans, of Phoenix, stated that he believes the ASRS' monthly payments to retirees are more than the contributions made by active members. He believes the current contribution rate of 2% impinges on the ability of the system to pay adequate and fair compensation to those who are retired. He also commented on the value of the dollar, inflation and the stock market.

Mr. Hal Marshall, of Tucson, offered support for Dr. DuVal's suggestion that the state group all state employees and retirees in one package for health insurance bids.

9. The next regular ASRS Board meeting is scheduled for Friday, November 17, 2000, at 8:30 a.m. in the ASRS Tucson office, at 7660 East Broadway Boulevard, Suite 108, Tucson, Arizona 85710.

10. Adjournment of the ASRS Board.

Mr. Jim Bruner, Vice-Chairman, adjourned the October 20, 2000 regular meeting of the ASRS Board at 11:27 a.m.

Respectfully submitted,

Maurah Harrison, Secretary

Date

LeRoy Gilbertson, Director

Date